

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

|  |          |                |
|--|----------|----------------|
| <b>Mt. Carmel Public Utility Co.</b>   | <b>:</b> |                |
|  | <b>:</b> |                |
| <b>Proposed general increase in</b>    | <b>:</b> | <b>07-0357</b> |
| <b>electric and natural gas rates.</b> | <b>:</b> |                |
| <b>(tariffs filed on May 4, 2007)</b>  | <b>:</b> |                |

**PROPOSED ORDER**

DATED: February 1, 2008



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**PROPOSED ORDER**

**I. INTRODUCTION**

**A. Procedural History**

On May 4, 2007, Mt. Carmel Public Utility Company ("MCPU" or "Mt. Carmel" or the "Company") filed revised tariff sheets ("Filed Rate Schedule Sheets") seeking an increase in electric and gas rates, which increase was to become effective on June 18, 2007. On May 4, 2007, MCPU made a filing in the nature of a Part 285 Filing, 83 Ill Admin Code Part 285, although MCPU is not subject to the Part 285 filing requirements due to the small size of the Company's operations. Part 285.120(d) provides that the standard information requirements are not applicable to sewer, water, gas or electric utilities providing service to fewer than 35,000 customers. Included in this filing was the direct testimony of Mr. Dan Long, MCPU Ex. 1.0, which referenced MCPU Exhibits 2.0 through 7.0, as well as Schedules A through E. No Deficiency Letter was issued under Section 285.145.

The Company proposed an original cost rate base for electric operations of \$12,919,069, and a proposed rate of return on rate base of 9.4910%. This proposal yields electric net operating income of \$1,226,149. This results in a requested revenue increase for electric operations of \$2,877,910 without add-on taxes. The Company proposed an original cost rate base for gas operations of \$2,645,486, and a proposed rate of return on rate base of 9.4910%. This proposal yields gas net operating income of \$251,083. This results in a requested revenue increase for gas operations of \$756,624 without add-on taxes.

On June 6, 2007, the Commission issued a Suspension Order which suspended the MCPU Filed Rate Schedule Sheets for the Commission to "enter upon a hearing concerning the propriety of the proposed general increase in electric and natural gas rates." On September 26, 2007, the Commission issued a Resuspension Order. On June 7, 2007, the Citizen's Utility Board ("CUB") filed a Verified Petition to Intervene. On July 11, 2007, the Administrative Law Judge ("ALJ") held a status hearing at which the petition of CUB to intervene was granted, and a schedule was set for the parties to file testimony. This matter was set for an evidentiary hearing on December 4, 2007. On

August 31, 2007, the City of Mt. Carmel ("City") filed a Verified Petition to Intervene, which was allowed on September 5, 2007.

Pursuant to the schedule set in this proceeding, Staff of the Illinois Commerce Commission ("Staff") filed the direct testimony of Mike Ostrander, Mary H. Everson, Greg Rockrohr, Mark Maple, Sheena Kight-Garlich, and Cheri L. Harden. The City filed the direct testimony of Brandi Stennett.

MCPU filed Rebuttal Testimony sponsored by its witness Mr. Long. On behalf of the Commission Staff, Mr. Ostrander, Ms. Everson, Mr. Rockrohr and Ms. Harden filed Rebuttal Testimony. On behalf of the City, Ms. Stennett filed Rebuttal Testimony. Surrebuttal testimony was filed on behalf of MCPU by Mr. Long.

Subsequent to these filings, an evidentiary hearing was held on December 4, 2007 at the offices of the Commission in Springfield, Illinois. Appearances at the hearing were entered on behalf of MCPU, Staff, and the City. At the conclusion of the hearing, the record was marked "Heard and Taken." Initial and Reply Briefs were filed by MCPU Staff and the City. A proposed order was served on the parties.

## **B. Nature of Operations**

Mt. Carmel is engaged in the business of providing electric and gas service to the public in the State of Illinois. MCPU is a regulated combination electric and gas utility with operations located primarily in Wabash County, Illinois. MCPU provides electric service at retail rates to over 7,000 customers, and provides gas service at retail rates to over 3,600 customers.

## **C. Test Year**

The Company initially proposed a historical test year for the twelve months ending December 31, 2005. Staff proposed changing the historical test year to the twelve months ending December 31, 2006. This issue is discussed further in the Rate Base section of this Order.

## **D. Applicable Law**

Section 9-101 of the Illinois Public Utilities Act (the "Act" or the "PUA") requires that "[a]ll rates or other charges made, demanded or received by any product or commodity furnished or to be furnished or for any service rendered or to be rendered shall be just and reasonable." Conversely, "[e]very unjust or unreasonable charge" or rate are "prohibited and declared unlawful." Ratepayers are also not required to pay for costs unless those costs can be shown to "directly benefit them or the services" which the utility renders. *Illinois Bell Tel. Co. v. Illinois Commerce Comm.*, 55 Ill. 2d 461, 482 - 483 (1973). 9-201 (c) of the Act provides in part that the "burden of proof to establish the justness and reasonableness of the proposed rates or other charges . . . shall be on the utility."



## **II. RATE BASE**

### **A. Uncontested Issues**

#### **1. Unamortized Rate Case Expense**

Staff witness Ostrander proposed an adjustment to remove unamortized rate case expense from the Company's electric and gas rate base. The purpose of removing unamortized rate case expense from rate base is to ensure that there is a fair and equitable allocation of rate case costs between ratepayers and shareholders. The removal of unamortized rate case expense from rate base is consistent with prior Commission practice. MCPU does not contest this adjustment. The Commission finds this proposed adjustment to be reasonable.

#### **2. 2006 Test Year**

Mt. Carmel initially proposed the use of a 2005 test year for this proceeding. Staff proposed an adjustment to update Mt. Carmel's rate case filing to a 2006 test year. Staff submitted that a 2006 test year is more recent and should be more reflective of current conditions upon which to base rates. MCPU did not contest this adjustment. The Commission finds this proposed adjustment to be reasonable, and will accept the use of a 2006 test year for this proceeding.

#### **3. General Office Allocation**

Staff further proposed an adjustment to allocate the general office building between electric and gas consistent with Staff's proposed adjustment to update MCPU's revenue requirement to a 2006 test year. The Company did not contest this adjustment. The Commission finds this proposed adjustment to be reasonable and will adopt this adjustment.

#### **4. Materials and Supplies Inventory**

Staff also proposed an adjustment to reduce the Company's materials and supplies inventory by the amount of accounts payable that are associated with the purchase of materials and supplies inventory. The Company did not contest this adjustment. The Commission finds this proposed adjustment to be reasonable and will adopt this adjustment.

#### **5. Test Year CWIP Accumulated Depreciation**

Staff proposed an adjustment to update the amount of the Company's pro forma adjustment to Accumulated Depreciation associated with Construction Work in Progress ("CWIP"). The Company did not contest this adjustment. The Commission finds this proposed adjustment to be reasonable and will adopt this adjustment.

## **6. Attorney's Office Accumulated Depreciation**

Staff proposed an adjustment to remove test year depreciation expense that was included in the accumulated depreciation component of the Company's pro forma adjustment to allocate the removal of the attorney's office from rate base since the Company had double counted test year depreciation expense. The Company did not contest this adjustment. The Commission finds this proposed adjustment to be reasonable and will adopt this adjustment.

## **7. Working Capital**

### **a. Cash Working Capital**

Staff proposed an adjustment to cash working capital using a methodology Staff was of the opinion was more appropriate than that used by the Company. Staff notes that MCPU calculated its electric and gas cash working capital requirement using a hybrid approach that combines the 1/8<sup>th</sup> method based on the operating expenses presented in its filing and the balance sheet method using prepaid expenses and accrued liabilities. Staff was of the opinion that use of this hybrid approach did not produce an appropriate result, as prepaid expenses and accrued liabilities are provided for in the 1/8<sup>th</sup> of operating expenses that are also included in MCPU's calculation. Staff's calculation of cash working capital requirement based upon the 1/8<sup>th</sup> method begins with Staff's proposed operating expenses and then removes items that do not require cash working capital. The cash working capital requirement is then 1/8<sup>th</sup> of this amount. The total working capital requirement is determined by adding inventories to the cash working capital requirement.

While MCPU did not initially accept Staff's proposed adjustment in its entirety, MCPU did not further address this issue following Staff's rebuttal testimony, nor did MCPU address this issue in either its Initial Post-Hearing Brief, or in its Reply Brief. It appears therefore to the Commission that MCPU has accepted Staff's proposed method of determining the appropriate level of cash working capital. The Commission finds this proposed adjustment by Staff to be reasonable.

### **b. Gas-Propane Inventory**

Staff proposes to disallow \$4,014 to reflect the known and measurable change associated with the inventory reduction from testing the propane facility. Staff witness Maple also recommended that the Commission direct Mt. Carmel to perform a study to determine the appropriate level of propane storage. Staff notes that MCPU did not dispute Mr. Maple's disallowance or recommendation in its rebuttal testimony. It appears to the Commission from the evidence presented, that this proposed adjustment is reasonable and should be adopted. It further appears appropriate to direct MCPU to perform a study to determine the appropriate level of propane storage, and MCPU should be further directed to provide this study to the Director of the Energy Division within 150 days of the Commission's Order in this proceeding.

**8. Utility Plant**

**a. Oak Street Project**

MCPU has proposed a pro forma rate base addition of \$300,000 for MCPU's Oak Street Project. Staff witness Rockrohr testified that this project, which equates to 2.2% of the rate base MCPU proposes, should only be allowed into MCPU's rate base if it is found to be both prudent and used and useful. Mr. Rockrohr initially testified that while his review showed MCPU's investment in the Oak Street Project to be prudent, it could not be considered used and useful until it was completed. Mr. Rockrohr stated that, though he is not an attorney, he interprets Section 287.40 of 83 Illinois Administrative Code to provide MCPU with up to 12 months after its filing date of May 4, 2007, to complete a project associated with a pro forma adjustment, such as the Oak Street Project. In surrebuttal testimony, Mr. Long testified that MCPU's Board of Directors had issued formal direction to the MCPU's operating staff to complete the Oak Street project prior to May 4, 2008, and provided copies of minutes from the relevant board meeting.<sup>1</sup> During the evidentiary hearing in this docket, Mr. Rockrohr indicated that his own observation of MCPU's construction progress on the Oak Street Project on November 15, 2007, caused him to believe MCPU would complete the Oak Street Project by May 4, 2008, and he therefore recommended no adjustment be made to MCPU's cost for this project in MCPU's rate base as a pro forma adjustment. It appears to the Commission that this pro forma rate base addition is prudent on the part of Mt. Carmel, and will also be used and useful before May 4, 2008, based on the evidence presented herein, and this proposed addition to rate base is therefore accepted by the Commission.

**b. W. 3<sup>rd</sup> Street Substation**

In its initial filing the Company proposed an addition to electric rate base related to Construction Work In Progress ("CWIP") associated with a new transmission line and substation. The total proposed CWIP amount is \$2,221,952.

Staff witness Rockrohr initially recommended a disallowance of \$1,884,766.79 for CWIP of the W. 3<sup>rd</sup> Street Substation if MCPU was unable to demonstrate that it will complete its construction within 12 months of the rate filing in this proceeding. Mr. Rockrohr indicated that in his opinion, MCPU's W. 3<sup>rd</sup> Street Substation and associated transmission lines would be used and useful, and therefore be appropriately considered for inclusion in rate base, only after MCPU places its 138/69 kV transformer in service at the W. 3<sup>rd</sup> Street Substation. On November 15, 2007, Mr. Rockrohr observed that the 138/69 kV transformer is now placed at the W. 3<sup>rd</sup> Street Substation, and he therefore withdrew his recommendation for this disallowance.

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<sup>1</sup> During the evidentiary hearing Mr. Long corrected the completion date written in his testimony from May 4, 2007 to May 4, 2008.

As Staff has now withdrawn this proposed disallowance, the Commission finds that the evidence shows that the CWIP pro forma adjustment for this substation is appropriate to be made and should be included in MCPU's rate base in this proceeding.

**c. New Transmission Line**

Mr. Rockrohr had initially proposed a disallowance of \$663,788 in CWIP for the new transmission line from Company's South Division Street Substation to the new substation being built on outer West Third Street. Mr. Rockrohr testified that he would withdraw his proposed disallowance if MCPU sought and received a Certificate of Public Convenience and Necessity ("CPCN") prior to the conclusion of this docket.

In accordance with Staff's recommendation, MCPU filed a Petition seeking a Certificate of Public Convenience and Necessity for the transmission line in question, in Docket No. 07-0530. Following the schedule set for 07-0530, Mr. Rockrohr filed testimony wherein he recommended that Commission grant the requested certificate to MCPU for the transmission line at issue. A hearing was held in Docket 07-0530 on January 15, 2008, at which time both MCPU and Staff entered their testimony into the record recommending the granting of the requested certificate. On January 30, 2008, the Commission considered 07-0530 and entered a Final Order granting a Certificate of Public Convenience and Necessity for this transmission line. As Mr. Rockrohr had indicated that he would reverse his recommendation to disallow the \$663,788 from rate base if MCPU received a Certificate of Public Convenience and Necessity for this transmission line from the Commission prior to the close of this proceeding, it appears to the Commission that this matter is no longer contested between the parties.

The Commission therefore finds that the construction of this new transmission line was both necessary to the operations of MCPU, and was used and useful prior to May 4, 2008, and the Commission will therefore allow this pro forma adjustment to Construction Work in Progress in rate base.

**B. Contested Issues**

**1. Pro Forma Vehicles**

**a. MCPU Position**

In its initial filing, the Company proposed the pro forma addition of five vehicles to electric rate base. These included a line truck (\$150,000), a service truck (\$75,000), two small service trucks (\$50,000 total) and a meter testing van (\$40,000).

MCPU notes that in direct testimony, no Staff witness took issue with the proposed vehicle additions. In rebuttal testimony however, Staff witness Mary Everson proposed an adjustment to remove the cost associated with these vehicles from rate base. Ms. Everson asserts that "Part 287.40 allows pro forma adjustments only if those adjustments are reasonably certain to occur subsequent to the historical test year within 12 months

after the filing date of the tariffs and where the amounts of the changes are determinable.” Part 287.40 states test year adjustments are those “that are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable.”

MCPU takes the position that this statement assumes that 83 Ill. Adm. Code 287 applies to the Company, which MCPU disputes. MCPU submits that if Part 287 does not apply to the Company, the constraints proposed by Ms. Everson should not be used to eliminate the proposed addition of these vehicles.

MCPU submits however, that should Part 287 be applicable to the Company, MCPU has taken actions sufficient to show the Commission that there is a reasonable certainty that these vehicles will be acquired in a timely manner. MCPU notes that it filed its proposed tariffs on May 4, 2007, which would mean that MCPU must show that there is a reasonable certainty that the vehicles must therefore be acquired prior to May 4, 2008. This is based on Part 287.40 stating that the adjustments are to occur within 12 months of the filing. MCPU notes that a portion of the difficulty with making this decision is that the deadline for a decision in this docket is March 30, 2008, while the vehicles could be purchased over a month later, and yet still be an appropriate pro forma adjustment to rate base. Mt. Carmel submits that Ms. Everson’s proposal to disallow this pro-forma adjustment would seem to be based, at least in part, on the fact that not all the vehicles were purchased prior to the December 4, 2007 hearing.

MCPU notes that in response to the testimony and concern raised by the parties on this issue, the Board of Directors of MCPU (the “Board”), at its regularly scheduled meeting on November 2, 2007, directed MCPU’s operating staff to order and purchase the vehicles proposed in the Company’s initial filing. The Board further directed that these vehicles be ordered and paid for such that the Company would expend these funds prior to May 4, 2008. MCPU further notes that at the evidentiary hearing held in this proceeding on December 4, 2007, Company witness Dan Long also provided exhibits that consisted of copies of actual purchase orders issued by the Company and confirmations by vendors for all five vehicles. MCPU posits that while Staff indicates it had little chance to give “normal review and scrutiny” to the documents, these documents were discussed in Mr. Long’s surrebuttal testimony.

MCPU notes that no party has questioned whether the suggested cost of the vehicles was inaccurate or inflated, nor has any party questioned the need for MCPU to purchase the vehicles in question. As Staff has suggested that Part 287.40 required that the expenditures take place no later than 12 months after the proposed rates had been filed, specifically May 4, 2008; MCPU considered Staff’s arguments and submits that it has taken the steps necessary to answer the concerns of Staff.

MCPU notes that the parties have questioned the indication of an inability of MCPU to afford these vehicles early in the rate case, which position changed in surrebuttal testimony. MCPU submits that the testimony of Mr. Long shows that because of the concerns raised by Staff and the City, the Board made the decision to use capital funds

from a 2007 loan to purchase the vehicles early in 2008, although current income at that time might not otherwise allow such expenditures.

MCPU submits that, in response to the concerns raised by Staff and the City, the Board issued formal direction that requires the Company to purchase the five vehicles prior to May 4, 2008. MCPU is of the opinion that not only has it complied with Part 287.40, but also met the conditions it believes were set by Staff, those being: (1) Board Approval, (2) unconditional commitment to incur the costs regardless of the amount of revenue granted, and (3) commitment that the costs would be incurred prior to 12 months following the filing of proposed rates, as required by Part 287.40.

MCPU submits further, in answer to the City, that the minutes of the board meeting of Mt. Carmel Public Utility, admitted into evidence at hearing as MCPU 2.0SR, were properly admitted into evidence, and that the objection made by the City, and renewed in its Initial Brief, are not well founded. MCPU opines that these Board minutes were admissible under the business records exception to the hearsay rule, Supreme Court Rule 236(a), and they were therefore properly admitted into evidence in this proceeding.

Mt. Carmel submits that a review of all the evidence, along with the intent of Part 287.40, shows that MCPU has met its burden under Part 287.40. Mt. Carmel is of the opinion that the pro-forma adjustment for the vehicles to be purchased should be allowed by the Commission, as Mt. Carmel has shown that the vehicles are reasonably certain to be purchased within 12 months of the filing of tariffs, and the amounts for the vehicles are determinable, as required under Part 287.40

#### **b. Staff Position**

Staff has proposed an adjustment to remove MCPU's proposed pro forma adjustments to rate base for the purchase of a line truck, a service truck, two small utility service trucks and a meter testing van. Staff submits that 83 Ill. Adm. Code 287.40 allows pro forma adjustments only if those adjustments are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable, and Staff is of the opinion that the evidence presented by Mt. Carmel does not show that these purchases are reasonably certain to occur.

Staff notes that MCPU indicated in its surrebuttal testimony that it had issued purchase orders for each of the five vehicles. In support of this testimony, MCPU witness Dan Long sponsored additional documentation in the form of confirmations of MCPU's orders from three third-party vendors for the purchase of four of the vehicles at the evidentiary hearing.

Staff submits that as this additional support was not introduced until the evidentiary hearing, Staff had no opportunity to evaluate the information or respond to it on the record. Staff opines that as this documentation has not been subjected to Staff's normal review

and scrutiny, this additional information should be accorded little weight by the Commission in the determination of this issue.

Staff notes that while there is some disagreement between the parties as to whether MCPU is subject to Part 287, Staff submits that the underlying ratemaking principles expressed in Part 287.40 should certainly apply, and Staff further submits that there is no other framework or standard against which the Commission could evaluate the Company's pro forma adjustments.

In analyzing the evidence presented by MCPU on this issue, Staff notes that in MCPU's rebuttal testimony filed in October 2007, MCPU witness Dan Long stated: "The Company lacks the funds to make these expenditures until rates have been increased." Staff further notes that Mr. Long also stated: "I have clearly demonstrated the Company did not have these funds, and requires rate relief to follow through with these expenditures." Staff submits that these statements, taken together, cast doubt on the ability of MCPU to purchase the vehicles within the 12-month timeframe.

Staff takes the position further, that while MCPU claims that it has taken the necessary steps to mitigate Staff's concerns regarding the reasonable certainty of the vehicle purchase, including MCPU's surrebuttal testimony indicating that the MCPU Board had directed the purchase of the vehicles in question, along with the issuance of purchase orders, in November 2007, this is insufficient. Staff submits that while the direction from the Board might indicate the Company's intentions, it does not demonstrate that it is reasonably certain that the Company will actually acquire the vehicles within the parameters reflected in 83 Ill. Adm. Code 287.40. Staff is of the opinion that the statements in MCPU's rebuttal testimony, which describe a financial situation that made it unlikely that MCPU would be able to effectuate the purchases prior to receiving new rates, make these vehicle purchases not reasonably certain to occur before May 4, 2008.

Staff therefore recommends that the Commission accept Staff's adjustment to remove the Company's pro forma adjustment for the purchase of a line truck, a service truck, two small utility service trucks and a meter testing van. Staff submits that the evidence fails to demonstrate that the Company's pro forma adjustment for these items reflects a change that is known and measureable and which is reasonably certain to occur within 12 months of the filing date of the tariffs.

### **c. City Position**

The City supports Staff's recommendation on this issue and urges the Commission to reject MCPU's pro-forma adjustments for the purchase of five new vehicles.

The City notes that not until MCPU filed its surrebuttal testimony, did MCPU indicate that its Board had passed a resolution that it would purchase the trucks. The City notes that MCPU admitted that "[t]his action may be seen as being in conflict with

previous statements regarding the lack of funds to make these purchases,” and that MCPU further indicated that it had only authorized the purchases when it realized “the impact of losing this cost recovery in the rate case revenue requirement.” The City submits that despite this testimony, there is no assurance that MCPU will proceed with the purchase, whether or not it receives the requested increase in revenues.

The City further submits to the Commission that the main evidence in support of this pro-forma adjustment, the board minutes and the purchase orders, were erroneously admitted into evidence over the objection of the City. The City notes that Mr. Long, MCPU’s witness, testified that he did not in fact, attend the board meeting, the minutes of which he was offering, nor did he indicate that he had personal knowledge of the contents of the board minutes he offered as evidence. The City further notes that Mr. Long admitted that it was not part of his duties in this docket to negotiate the vehicle contracts nor did he have any contact with the persons involved in such negotiations.

While counsel for MCPU indicated that the minutes were admissible under a business record exception to the hearsay rule, the City submits that they were not, and that the Administrative Law Judge erred in allowing the documents to be admitted into evidence. In order for a business record to be admissible as an exception to the hearsay rule under Supreme Court Rule 236 “an adequate foundation must still be laid before it is admitted into evidence.” *Greaney v. The Industrial Commission*, 358 Ill. App. 3d 1002, 1011 (1<sup>st</sup> Dist. 2005). The City submits that a proper foundation requires authentication and identification, and as it appears to the City that MCPU failed to properly authenticate and identify the minutes of the board meeting and the purchase orders, it was error to allow them into evidence.

The City submits that MCPU waited until after Staff and City rebuttal testimony to address the issue of the pro-forma adjustment for vehicles presented in this case. The City further questions the ability of MCPU to make the vehicle purchases, as not until surrebuttal did MCPU indicate it had sufficient funds for the purchases. The City submits that this preventing Staff and the City from properly scrutinizing these claimed purchases and proposed hires.

The City submits that MCPU did not present sufficient, credible and legally admissible evidence to support its adjustments to add yet-to-be purchased vehicles, and absent a true commitment by the Utility to purchase the vehicles, the pro forma adjustment for the purchase of the vehicles should be rejected.

#### **d. Commission Analysis and Conclusion**

MCPU, Staff and the City address the issue of whether this pro-forma adjustment, pursuant to 287.40, is reasonably certain to occur within 12 months of the filing of the tariffs, and whether the amount is determinable. MCPU initially took the position that it could not commit to purchasing these vehicles unless they were allowed into rate base, and if there were not allowed into rate base, then they would not be purchased. When this position was objected to by Staff and the City, MCPU indicates it



took steps to satisfy the parties concerns. These steps included action by the Board of Mt. Carmel directing the purchase of the vehicles in question, and Mt. Carmel eventually issued purchase orders for the vehicles. It does not appear to the Commission that as of the evidentiary hearing, December 4, 2007, that any of the vehicles had in fact been purchased. Staff and the City remain opposed to this pro-forma adjustment, both indicating their position that there is insufficient evidence to show the Commission that these purchases will occur with a “reasonable certainty.”

It is clear to the Commission that the position first adopted by MCPU, “if you give us these in rate base we’ll buy them, and if you don’t we won’t”, is insufficient to support the requested pro-forma adjustment. The question then becomes what is sufficient to show that these purchases are reasonably certain to occur. As noted, part of the difficulty is that there is in essence a one year timeline to make the change, when a rate case has a timeline of approximately 11 months. Part 287.40 clearly contemplates a utility being rightfully allowed to make a pro-forma adjustment to rate base for something that will occur after an Order has been entered by the Commission.

The Commission must therefore judge what assurances have been made by the utility, and whether these assurances show that the purchases are a reasonable certainty. MCPU has presented evidence showing that its Board has directed that the vehicles in question be purchased prior to May 4, 2008. MCPU further presented at hearing copies of purchase orders which had been issued for each of the vehicles for which Mt. Carmel is seeking the pro forma adjustment. It appears to the Commission that Mt. Carmel has made a sufficient showing that the purchase of each of the five vehicles is reasonably certain to occur prior to May 4, 2008, and that the cost is determinable. As Mt. Carmel noted, it does not appear that any party has contested whether the costs are determinable or reasonable, but only whether the purchases were reasonably certain to occur. The Commission is at a loss as to what evidence could have been adduced that would have made the purchases more certain to occur, so as to satisfy Staff and the City, short of the actual purchase of the vehicles. Importantly, the question is whether there is reasonable certainty, not absolute certainty.

The Commission is aware of the risk of allowing this pro-forma adjustment, placing these vehicles into Mt. Carmel’s rate base, and then, should these vehicles not be purchased, could put Mt. Carmel into an over-earning situation. The Commission trusts that Mt. Carmel understands the risk that taking that action would mean to future proceedings involving MCPU. The Commission would certainly take a dim view of any utility which made certain representations and assurances to the Commission of the actions it would take, and then fails to follow through on those representations. Mt. Carmel has represented to the Commission that these vehicles will be purchased prior to May 4, 2008, and has presented various testimony and documents to support that position. The Commission finds that there is a reasonable certainty that these vehicles will be purchased prior to May 4, 2008, and will therefore allow this pro-forma adjustment by Mt. Carmel. The Commission also deems it appropriate to direct Mt. Carmel to file a report on the first of each month to the Manager of the Commission’s Accounting Department on the status of the purchases, until all five vehicles have been

purchased. Should these filings not indicate that each of the vehicles have been purchased by May 4, 2008, then the Manager of the Accounting Department, in consultation with other Commission Staff, shall consider whether it is appropriate to recommend that the Commission begin a rate investigation on the Commission's own motion under 9-250 of the Act. The Commission notes further that neither Staff nor the City questioned whether the amounts for these vehicles was determinable or unreasonable, therefore the Commission will find that the purchase prices of the vehicles in question are determinable.

The Commission would note that while it is of course concerned with the added expense to customers by allowing this adjustment, the Commission must also concern itself with a utility's ability to provide reliable service to its various customers. No party has questioned whether these vehicles are needed by Mt. Carmel to provide safe and efficient utility service to its customers.

The Commission also notes an issue raised by the City as to the order in which the parties presented their testimony at the evidentiary hearing, indicating that the order of witnesses was contrary to customary Commission practice. It appears from a reading of the transcript that the order of witnesses was decided on by the parties, and there appear to have been no requests to recall witnesses after Mr. Long's testimony. While the Commission discourages the filing of evidence on the day of an evidentiary hearing whenever possible, this may not always be possible. The Commission also notes that both the minutes of the Board of Directors and the issuance of purchase orders for the vehicles were discussed in Mr. Long's surrebuttal testimony, filed prior to the evidentiary hearing. The Commission is satisfied that the documents to which the City objected during hearing were properly admitted into evidence in this proceeding for the Commission to consider.

The Commission will therefore allow Mt. Carmel to make the requested pro forma adjustment to rate base for the vehicles in question, subject to the conditions discussed above, and will not adopt the proposed adjustment suggested by Staff and the City.

### **C. Approved Rate Base**

Based on the electric utility delivery services rate base as originally proposed by Mt. Carmel, along with the conclusions above, the electric utility rate base for Mt. Carmel is \$12,273,453. Based on the gas utility delivery services rate base as originally proposed by Mt. Carmel, along with the conclusions above, the gas utility rate base for Mt. Carmel is \$2,116,303. These rate bases are summarized as follows:

#### **Approved Rate Bases**

##### Electric Operations

|                          |    |                     |
|--------------------------|----|---------------------|
| Utility Plant in Service | \$ | 22,115,680          |
| Accumulated Depreciation |    | <u>(12,659,749)</u> |

|                           |                      |
|---------------------------|----------------------|
| Net Plant                 | 9,455,931            |
| Additions to Rate Base    |                      |
| CWIP                      | 2,555,927            |
| Working Capital Allowance | 882,768              |
| Unamortized Rate Case     |                      |
| Expense                   | -                    |
| Deductions From Rate Base |                      |
| Deferred Income Taxes     | (507,907)            |
| Customer Deposits         | <u>(113,266)</u>     |
| RATE BASE                 | <u>\$ 12,273,453</u> |

The development of the overall electric utility delivery services rate base adopted for purposes of this proceeding is shown in Appendix A to this Order.

#### Gas Operations

|                           |                     |
|---------------------------|---------------------|
| Utility Plant in Service  | \$ 5,226,055        |
| Accumulated Depreciation  | <u>(3,242,674)</u>  |
| Net Plant                 | 1,983,381           |
| Additions to Rate Base    |                     |
| Working Capital Allowance | 248,347             |
| Unamortized Rate Case     |                     |
| Expense                   | -                   |
| Deductions From Rate Base |                     |
| Deferred Income Taxes     | (47,328)            |
| Customer Deposits         | <u>(68,097)</u>     |
| RATE BASE                 | <u>\$ 2,116,303</u> |

The development of the overall gas utility delivery services rate base adopted for purposes of this proceeding is shown in Appendix B to this Order.

### **III. OPERATING REVENUES AND EXPENSES**

#### **A. Uncontested Issues**

##### **1. Contributions to Community and Economic Development Organizations**

Staff proposed an adjustment to remove contributions to community and economic development organizations from the electric and gas revenue requirements. Section 9-227 of the Act allows as an operating expense contributions made by a utility for the public welfare or for charitable scientific, religious or educational purposes. Staff submits that contributions to community and economic development organizations is a promotional and goodwill practice, and therefore these contributions should be removed from the Company's electric and gas revenue requirements. Staff opines that the Commission has consistently adopted a similar position in other rate cases. MCPU does not appear to contest this adjustment, as it was not addressed in either Mt. Carmel's Initial Brief or its Reply Brief. The Commission finds this adjustment reasonable.

##### **2. Advertising Expense**

Staff proposed an adjustment to disallow a portion of advertising expense that is goodwill in nature. Staff notes that it is not appropriate for utilities to recover in rates amounts for goodwill advertising. Section 9-225(2) of the Act defines goodwill advertising, as advertising designed primarily to promote the image or name of the Company or promote industry wide issues, which should not be considered for the purpose of determining rates for gas or electric utilities. Staff submits that it is not appropriate for captive customers to pay for advertising that has the purpose which promotes the Company, rather than providing information regarding service-related matters. Staff further notes that the Commission has previously accepted an adjustment to disallow goodwill advertising expense in the orders entered in 1996 and 1998 for MCPU's prior rate cases. As MCPU did not address this issue in either its Initial Brief or Reply Brief, it appears to the Commission that this proposed adjustment is no longer contested. The Commission finds this proposed adjustment to be reasonable.

##### **3. Industry Association Dues**

Staff proposed an adjustment to reduce industry association dues. The adjustment removed the portion of dues related to lobbying efforts. Staff submits that this is consistent with Section 9-224 of the Act which states that the Commission shall not consider as an expense of any public utility company, for the purpose of determining any rate or charge, any amount expended for political activity or lobbying as defined in the "Lobbyist Registration Act". As MCPU did not address this issue in either its Initial Brief or Reply Brief, it appears that this adjustment is no longer contested. The Commission finds this proposed adjustment to be proper and approves of this treatment.

#### **4. Lobbying Expense**

Staff proposed an adjustment to exclude lobbying expenses from the Company's electric and gas revenue requirements. Relying upon Section 9-224 of the Act, the adjustment reduces test year operating expense for payment of lobbyist registration fees. The adjustment also excludes a percentage of the salary and benefits of a Mt. Carmel employee who is registered as a lobbyist for the Company. As MCPU did not address this adjustment in rebuttal or surrebuttal testimony, or in either of its post-hearing briefs, it appears to the Commission that this proposed adjustment is unopposed. The Commission approves of this adjustment and finds it reasonable.

#### **5. Miscellaneous General Expense**

Staff proposed an adjustment to exclude the write off of amounts due for utility services of deployed military personnel from the Mt. Carmel service area. Staff submits that the practice of writing off amounts due for utility services of deployed military personnel is similar to contributing to community and economic development organizations, and as stated above, Section 9-227 of the Act allows as an operating expense contributions made by a utility for the public welfare or for charitable scientific, religious or educational purposes. Staff submits that Mt. Carmel's practice of writing off amounts due for utility services of deployed military personnel is not for the public welfare or for charitable, scientific, religious or educational purposes, and while it may demonstrate good corporate citizenship, it is not necessary in providing utility service. Staff submits that ratepayers should not be burdened with the expense of the Company writing off amounts due for utility services of deployed military personnel. Staff suggests that should MCPU wish to continue this practice, it could begin a formalized process of soliciting contributions from ratepayers, or seek Commission approval, in a separate filing, of a tariff enunciating the Company's practice of providing free utility service for deployed military personnel, so that this practice would be included in Mt. Carmel's schedule of rates.

While Mt. Carmel initially disputed this proposed adjustment, as MCPU did not address this issue in either its Initial Brief or its Reply Brief, it appears that Mt. Carmel is no longer contesting this proposed adjustment.

The Commission finds this proposed adjustment to be reasonable.

#### **6. General Office Allocation**

Staff further proposed an adjustment to allocate the general office building between electric and gas consistent with Staff's proposed adjustment to update MCPU's revenue requirement to a 2006 test year. The Company did not contest this adjustment. The Commission finds this proposed adjustment to be reasonable.

## **7. Affiliate Transactions**

Staff witness Everson proposed an adjustment to remove the affiliate transactions between MCPU and Koger & Bramlet since Eric Bramlet is an officer and director of MCPU and is also a partner in the law firm of Koger & Bramlet. Ms. Everson recommended that the Commission order MCPU to prepare and file an affiliate agreement governing the transactions between Mt. Carmel and its affiliate, Koger & Bramlet. Ms. Everson further indicated in testimony and at the evidentiary hearing that she would withdraw this proposed adjustment should Mt. Carmel receive Commission approval of an affiliate agreement.

Mt. Carmel filed for approval of an affiliate agreement on October 12, 2007. On December 19, 2007 the Commission approved MCPU's affiliate agreement in Docket No. 07-0510. As it appears to the Commission that Staff is no longer proposing an adjustment for the affiliate transactions, the Commission will not order this adjustment.

### **B. Contested Issues**

#### **1. Payroll Expense**

The Commission notes that the arguments and positions set forth by Mt. Carmel, Staff and the City on this issue are essentially identical to the positions set forth on the pro-forma adjustment for vehicles discussed earlier. The Commission will consider the same arguments and positions expressed earlier to also apply to this issue.

##### **a. MCPU Position**

In its initial filing Mt. Carmel proposed an addition to operating expenses associated with five new Company personnel. Company witness Dan Long describes these additions to electric expenses as three vegetation management employees and a store room supervisor. Mr. Long also describes personnel additions to gas expenses for a gas utility man as well as an additional expense associated with a portion of the costs allocated to gas expenses associated with the addition of the store room supervisor. Mt. Carmel notes that during the course of these proceedings, two of these positions were filled by MCPU.

Staff again in rebuttal testimony proposed an adjustment to disallow this pro forma adjustment arguing the adjustment was not reasonably certain to occur in accordance with Part 287.40. As a result of Staff's concerns, MCPU notes that as with the vehicle adjustment, the Board at its November 2, 2007 meeting issued specific direction to the Company's operating Staff that they should act in a manner such that the remaining three positions should be filled prior to May 4, 2008. Mt. Carmel submits that in addition to the direction of the Board as assurance that these positions will be filled, Mt. Carmel had in fact filled two of the positions prior to the evidentiary hearing.

Mt. Carmel submits that it has satisfied Part 287.40, and that the test year adjustments are in fact reasonably certain to occur within 12 months after the filing date of the tariffs, and that the amounts of the changes are determinable. Mt. Carmel again notes that no party has challenged the reasonableness of the cost of the positions, or that the costs were not determinable.

MCPU again submits that Staff's position as to how to justify this adjustment has constantly changed, is not consistent with Part 287.40 in that it does not allow the full 12 months to make the adjustments, and does not acknowledge the reasonable assurance and commitment taken by the Company. Mt. Carmel submits that it has met its burden under Part 287.40, and the Commission should not disallow this pro forma adjustment.

**b. Staff Position**

Staff has proposed an adjustment to exclude from Mt. Carmel's electric and gas revenue requirements pro forma payroll expense for three positions that Mt. Carmel indicates that it intends to fill. Staff posits that 83 Ill. Adm. Code 287.40 limits pro forma adjustments to adjustments that are known and measurable and that are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs. While Staff initially proposed an adjustment for all five positions, Mt. Carmel has shown that two of the positions, a tree trimmer and gas utility man, have been hired.

Staff again submits that the assurances offered by Mt. Carmel, essentially the minutes of a Board meeting wherein the Board authorized the hiring of the pro forma personnel prior to May 4, 2008, is insufficient to provide the Commission with reasonable assurance that the Company will actually hire the remaining personnel within the parameters established by 83 Ill. Adm. Code 287.40.

Staff maintains that while this corporate directive might indicate the Company's intentions, it does not demonstrate that it is reasonably certain that the Company will actually hire the remaining personnel within the parameters established by 83 Ill. Adm. Code 287.40. Staff submits that MCPU has presented the Commission with insufficient evidence to demonstrate that the Company's pro forma payroll expense adjustment is known and measurable, verifiable on the record, and certain of effectuation, and therefore the Commission should accept Staff's adjustment to exclude from the respective electric and gas revenue requirements the payroll expense attributed to the remaining pro forma personnel.

**c. City Position**

The City concurs with Staff that MCPU has not shown that the Utility ought be allowed to make a pro forma adjustment for the future hiring of three additional employees at a cost of \$241,993. The City notes that while MCPU initially requested a pro forma adjustment for two other employees, those employees have been hired and the adjustment for those actual employees is not contested. Staff recommended, and

the City concurs, that the adjustment for the three potential future employees be disallowed from the pro forma payroll expenses because the hiring is not known and measurable and reasonably certain to occur within 12 months of the filing of the tariffs in this case as required by law.

The City is of the opinion that the same arguments as made on the adjustment for vehicles are applicable to the personnel adjustment. The City submits that Mt. Carmel has made insufficient assurances that these positions will be filled prior to May 4, 2008, and what evidence was presented at the hearing was admitted in error.

The City opines that MCPU did not present sufficient, credible and legally admissible evidence to support its adjustments to add yet-to-be hired personnel, and therefore these pro forma adjustments should be rejected by the Commission.

#### **d. Commission Analysis and Conclusion**

The Commission notes that the arguments regarding this adjustment are essentially the same as those regarding the pro forma vehicle adjustment discussed above, and in fact, portions of the parties Briefs discuss the two issues together. Based upon the evidence in the record, it appears to the Commission that Mt. Carmel has presented sufficient evidence to demonstrate that these personnel hires are reasonably certain to occur prior to May 4, 2008, in conformity with Part 287.40. The Commission again must balance the costs to customers with a utility's ability to provide safe, efficient and reliable service to those same customers. No party has questioned that the hiring of these personnel will aid Mt. Carmel in providing such service. The Commission notes that in support of this opinion, Mt. Carmel has in fact already filled two of the positions, adding some credence to the belief that Mt. Carmel will follow through with the filling of these new positions. The Commission finds, as expressed earlier in the pro forma vehicle section of this Order, that Mt. Carmel has shown pursuant to Part 287.40 that these pro forma adjustment are reasonably certain to occur prior to May 4, 2008, and that the amounts of these adjustments are determinable. The Commission will therefore allow Mt. Carmel to make this pro forma adjustment to its 2006 historical test year, and will not adopt the proposed adjustment put forth by Staff and the City.

### **2. Amortization of Rate Case Expense**

#### **a. MCPU Position**

Mt. Carmel has proposed a three-year period for amortization of rate case expense. Mt. Carmel submits that the City's recommendation for an eight-year amortization period is without merit and without proper evidentiary support and should be given no weight. MCPU notes that the Administrative Law Judge ruled at hearing that "Ms Stennett's testimony regarding the amortization of rate case expense will be, as indicated by Mr. Balough, treated not as an expert opinion but merely a recitation of the facts." MCPU notes that the recommendation made by Staff and the Company is for a three year amortization period that is in line with the period adopted in past



proceedings, and more reflective of how activities will occur in the absence of the artificial influences of the now expired mandatory transition period.

While MCPU notes that Staff takes the position that the Company was not prohibited from filing for an increase during the rate-freeze period, Mt. Carmel opines that this should have no bearing on the amortization period for rate case expenses requested by the Company and supported by the Staff. While MCPU notes Staff's position is that MCPU could have either filed a hardship rate case or filed new delivery service tariffs, MCPU submits that the first would have only resulted in higher rates for the Company's customers at an earlier date, and the second would have been a waste of time, money and resources for all involved, as Mt. Carmel had no delivery service customers. Mt. Carmel notes that in spite of Ms. Everson's additional comments, Staff did not change its position that three years was the appropriate amortization period for rate case expenses. Mt. Carmel notes further that Mr. Ostrander testified that the time frame to amortize rate case expense should correspond with the practical life of the electric and gas rates resulting from this docket, and that in MCPU's last rate case prior to the ten year rate freeze, Dockets No. 97-0513/97-0514 (consol.), the Company utilized a three year rate case expense amortization period.

Mt. Carmel references the City's Post-Hearing Brief, wherein the City noted "Good reason may exist and situations may arise that warrant deviating from a historical pattern, but absent such, Staff's analysis of historical patterns is the generally preferred approach." Aqua Illinois, Inc. Proposed General Increase, ICC Docket Nos. 05-0071 and 05-0072, Final Order at 48 (Nov 8, 2005). Mt. Carmel states Staff's analysis itself shows a historical 3 year amortization period when the rate freeze anomaly is accounted for, and the lack of Staff making a proposed adjustment supports the Company's position. Mt. Carmel further notes that the Aqua Order, also at page 48, states that in determining appropriate rate case expense amortization periods, the Commission generally concurs with Staff.

Mt. Carmel submits that the City's proposal is without merit and cannot be given serious consideration as it is not supported by expert opinion. Mt. Carmel submits that the proposed three year amortization period is reasonable and should be adopted by the Commission.

#### **b. Staff Position**

Staff did not address this issue in either its Initial Brief or Reply Brief. In rebuttal testimony, Staff witness Ostrander noted that the City had proposed an eight year amortization period for rate case expense. Mr. Ostrander noted that the City had included the ten year rate freeze in determining the City's recommended amortization period of eight years for rate case expense; versus the Company's three year amortization period. While Staff notes that MCPU views the rate freeze period as an anomaly that should be left out when determining the rate case expense amortization period, Staff submits that Mt. Carmel was not necessarily prohibited from filing a delivery services rate case during the rate freeze period. Staff notes however, if MCPU

believed it was constrained from filing a rate case, this presumably would have impacted the timing and frequency of its rate cases. Staff submits that the time frame to amortize rate case expense should correspond with the practical life of the electric and gas rates resulting from this docket. Staff further notes that in the Company's last rate case prior to the ten year rate freeze, ICC Dockets No. 97-0513 / 97-0514 (consol.), the Company utilized a three year rate case expense amortization period. Staff therefore does not propose an adjustment for an alternative amortization period in this proceeding.

**c. City of Mt. Carmel Position**

The City submits that rather than the three year amortization period proposed by MCPU for rate case expense, a more appropriate period would be eight years. The City submits that the length of the recovery period should be based on the average of the time between the Utility's last three rate cases. The City submits the Mt. Carmel filed for rate cases in 1982, 1995 and 1997. The City opines that using the time between rate cases shows that Mt. Carmel files a rate case about every eight years. The City notes that while Mt. Carmel argues it was prohibited from filing a rate case from 1997 and 2007 due to the rate freeze, Staff testified that this was not correct.

The City opines that generally, the Commission favors using historic data as an objective basis for determining the rate case expense recovery period, and that the rate recovery period should be reasonable and related to the estimated life that the rates will remain in effect. The City further notes that Staff appears to have used historic data for determining the amortization period in the past in other dockets, including the Aqua Illinois rate case, Docket Nos. 05-0070 and 05-0072.

The City submits that in this docket, the historical data show that the rates have an average life of eight years, and as Mt. Carmel has presented no evidence that it will be seeking another rate increase within three years, the three-year period sought is unreasonable given the historic data. The City submits that an eight year amortization period is warranted in this proceeding due to the historical data presented.

**d. Commission Analysis and Conclusion**

The Commission is of the opinion that a three year amortization period is appropriate in this proceeding, as agreed to by Mt. Carmel and Staff. It appears the intervention of the rate freeze period is a sufficient anomaly to argue against a mathematical determination of the time between rate cases. While Staff notes that Mt. Carmel was not necessarily prohibited from filing for a rate increase during the freeze, Staff seems to indicate that this may not have been an unreasonable belief on the part of Mt. Carmel. As a three year amortization period has previously been found appropriate for Mt. Carmel rate case expense in prior proceedings, the Commission deems it appropriate to continue with that period for this docket.

**C. Approved Operating Expenses and Revenues**

Based on the electric and gas utility delivery services operating expense statements as originally proposed by Mt. Carmel, and the adjustments to operating revenues and expenses as summarized above, the total electric utility delivery services net operating income approved for purposes of this proceeding for Mt. Carmel is \$1,147,568; and the total gas utility delivery services net operating income approved for purposes of this proceeding for Mt. Carmel is \$197,874.

**Approved Operating Statements**

Electric Operations

|                                       |                            |
|---------------------------------------|----------------------------|
| Base Rate Revenues                    | \$ 11,174,961              |
| Other Revenues                        | 219,404                    |
| Total Operating Revenue               | <u>11,394,365</u>          |
| Uncollectible Accounts                | -                          |
| Operation and Maintenance Expense     | 8,716,672                  |
| Depreciation and Amortization Expense | 620,110                    |
| Taxes Other Than Income               | <u>187,333</u>             |
| Total Operating Expense               |                            |
| Before Income Taxes                   | 9,524,115                  |
|                                       | -                          |
| State Income Tax                      | 153,159                    |
| Federal Income Tax                    | 567,788                    |
| Deferred Taxes and ITCs Net           | 1,735                      |
| Total Operating Expenses              | <u>10,246,797</u>          |
| NET OPERATING INCOME                  | <u><u>\$ 1,147,568</u></u> |

The development of the overall electric utility delivery services operating expense statement adopted for purposes of this proceeding is shown in Appendix A to this Order.

Gas Operations

|                                       |                  |
|---------------------------------------|------------------|
| Base Rate Revenues                    | \$ 4,727,144     |
| Other Revenues                        | 14,203           |
| Total Operating Revenue               | <u>4,741,347</u> |
| Uncollectible Accounts                | -                |
| Operation and Maintenance Expense     | 4,346,940        |
| Depreciation and Amortization Expense | 144,363          |

|  |                   |
|--|-------------------|
| Taxes Other Than Income                        | <u>25,431</u>     |
| Total Operating Expense<br>Before Income Taxes | 4,516,734         |
|  | -                 |
| State Income Tax                               | 41,137            |
| Federal Income Tax                             | (14,398)          |
| Deferred Taxes and ITCs Net                    | -                 |
| Total Operating Expenses                       | <u>4,543,473</u>  |
| NET OPERATING INCOME                           | <u>\$ 197,874</u> |

The development of the overall gas utility delivery services operating expense statement adopted for purposes of this proceeding is shown in Appendix B to this Order.

#### IV. COST OF CAPITAL/RATE OF RETURN

##### A. Capital Structure and Cost of Long-Term Debt

Staff submits that as proposed in ICC Staff Exhibit 5.0 and Schedule 5.1 thereof, the Company's capital structure may be summarized as follows:

| <u>Class of<br/>Capital</u> | <u>Pro-Forma<br/>June 30, 2007<br/>Balance</u> | <u>Percent of<br/>Total Capital</u> |
|-----------------------------|--|-------------------------------------|
| Long-Term Debt              | \$ 8,000,000                                   | 55.37%                              |
| Common Equity               | <u>\$ 6,449,011</u>                            | <u>44.63%</u>                       |
| TOTAL                       | \$14,449,011                                   | 100.0%                              |

Ms. Kight-Garlich proposed a capital structure measurement date of June 30, 2007. However, she testified that the Company restructured all of its debt in August 2007, and she, therefore, adjusted the Company's actual long-term debt balance as of June 30, 2007 to reflect the new debt. She also adjusted the Company's proposed common equity balance to reflect the actual amount outstanding as of June 30, 2007. She additionally testified that the Company's capital structure is commensurate with an adequate degree of financial strength.

With regard to the cost of debt, Staff states that MCPU's cost of long-term debt is 7.13%. Ms. Kight-Garlich adjusted the Company's proposed cost of debt to include the unamortized debt expense.

The Commission finds that Staff's proposed capital structure and cost of debt are reasonable and should be adopted for purposes of this proceeding.

## **B. Cost of Common Equity**

In its filing, MCPU proposed a return on common equity of 12.39%.

Staff witness Kight-Garlich estimated the investor-required rate of return on common equity to be 12.10% for MCPU. Ms. Kight-Garlich measured the investor-required rate of return on common equity with discounted cash flow ("DCF") and Capital Asset Pricing Model ("CAPM") analyses. Because the common stock of MCPU is not publicly traded, the DCF and risk premium models must be applied to samples of utilities of comparable risk. Ms. Kight-Garlich's sample ("Utility Sample") comprises eleven market-traded electric and gas utilities within S&P's Utility Compustat II database that paid dividends, had business profile scores of 4 or 5, had an S&P credit rating of BBB+, BBB or BBB-, were not in the process of being acquired by another company or acquiring a company of nearly equal or greater size, and for which growth forecasts were available from Zacks Investment Research ("Zacks").

### **1. Staff DCF Analysis**

DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments to the holders of that stock. Since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that a stock price embodies. The companies in Ms. Kight-Garlich's Utility Sample pay dividends quarterly. Therefore, Ms. Kight-Garlich applied a constant-growth quarterly DCF model.

DCF methodology requires a growth rate that reflects the expectations of investors. Staff witness Kight-Garlich measured the market-consensus expected growth rates with projections published by Zacks. The growth rate estimates were combined with the closing stock prices and dividend data as of August 23, 2007. Based on this growth, stock price, and dividend data, Ms. Kight-Garlich's DCF estimate of the cost of common equity was 9.93% for the Utility Sample.

### **2. Staff Risk Premium Analysis**

According to financial theory, the required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with that security. The risk premium methodology is consistent with the theory that investors are risk-averse and that, in equilibrium, two securities with equal quantities of risk have equal required rates of return. Staff witness Kight-Garlich used a one-factor risk premium model, the CAPM, to estimate the cost of common equity. In the CAPM, the risk factor is market risk, which cannot be eliminated through portfolio diversification.

The CAPM requires the estimation of three parameters: beta, the risk-free rate, and the required rate of return on the market. For the beta parameter, Ms. Kight-Garlich combined betas from Value Line and a regression analysis. The average

Value Line beta estimate was 0.95, while the regression beta estimate was 0.78. She averaged those results to derive a final beta estimate of 0.86. For the risk-free rate parameter, Ms. Kight-Garlich considered the 4.25% yield on four-week U.S. Treasury bills and the 5.06% thirty-year U.S. Treasury bonds. Both estimates were measured as of August 23, 2007. Forecasts imply a long-term, nominal risk-free rate between 4.6% and 5.6%. Therefore, to the extent inflation and real GDP growth expectations coincide with EIA, Global Insight, and *Survey* forecasts, the U.S. Treasury bond yield more closely approximates the long-term risk-free rate. Therefore, Ms. Kight-Garlich concluded that the U.S. Treasury bond yield is the better proxy for the long-term risk-free rate currently. Finally, for the expected rate of return on the market parameter, Ms. Kight-Garlich conducted a DCF analysis on the firms composing the S&P 500 Index. That analysis estimated that the expected rate of return on the market was 13.38% for the second quarter of 2007. Inputting those three parameters into the CAPM, Ms. Kight-Garlich calculated a cost of common equity estimate of 12.22% for the Utility Sample.

### **3. Staff Recommendation and Commission Conclusion**

Ms. Kight-Garlich testified that a thorough cost of common equity analysis requires both the application of financial models and the analyst's informed judgment. Because cost of common equity measurement techniques necessarily employ proxies for investor expectations, judgment is necessary to evaluate the results of such analyses. Along with DCF and CAPM analyses, Ms. Kight-Garlich considered the observable 6.28% rate of return the market currently required on A-rated utility long-term debt.

Ms. Kight-Garlich noted the limited market activity for the common stock of MCPU, a standalone company. Consequently, she concluded that MCPU's common stock is likely subject to liquidity costs. According to Staff, liquidity costs arise from the probability and financial consequences of an investor's inability to sell an asset at the desired time at a predictable price. In contrast, Ms. Kight-Garlich's utility sample comprises market-traded companies whose security prices do not reflect substantial liquidity costs. Therefore, Ms. Kight-Garlich adjusted the cost of common equity estimate for her Utility Sample by adding a liquidity premium.

Ms. Kight-Garlich estimated the investor-required rate of return on common equity by averaging the DCF-derived estimate and CAPM-derived estimate of the required rate of return on common equity for the Utility Sample, or 11.08%. Next, she added a liquidity premium of 102 basis points, which represents the difference between the current 6.05% yield on one-month A2 commercial paper and the current 7.07% interest rate on MCPU's loan. Based on her entire analysis, Ms. Kight-Garlich determined that a fair return on common equity for MCPU equals the cost of common equity for the Utility Sample, 11.08%, plus 102 basis points, or 12.10%.

The Commission finds Staff's recommended rate of return on common equity, 12.10%, to be reasonable and it is hereby adopted for purposes of this proceeding.

### C. Commission Authorized Rate of Return on Rate Base

Giving consideration to the conclusions above regarding capital structure and the costs of the various components of the capital structure, the Commission authorizes Mt. Carmel the opportunity to earn a 9.35% rate of return on net original cost rate base. Upon incorporation of the conclusions stated above, the Commission finds that MCPU's capital structure and cost of capital, resulting in overall cost of capital of 9.35% may be summarized as follows:

| <u>Class of Capital</u> | <u>Proportion</u> | <u>Cost</u> | <u>Weighted Cost</u> |
|-------------------------|-------------------|-------------|----------------------|
| Long-term debt          | 55.37%            | 7.13%       | 3.95%                |
| Common Equity           | <u>44.63%</u>     | 12.10%      | <u>5.40%</u>         |
| <b>TOTAL</b>            | <b>100.00%</b>    |             | <b>9.35%</b>         |

The Commission finds that this overall cost of capital to be reasonable and should be used for purposes of MCPU's authorized rate of return on rate base in this proceeding.

## V. COST OF SERVICE STUDY/RATE DESIGN

### A. Uncontested Issues

#### 1. Cost of Service – Gas and Electric

The Company filed a Cost of Service Study ("COSS") for both the gas and electric portions of its filing. Staff witness Harden found the Company's embedded cost of service study for both electric and gas to be acceptable for ratemaking in this case. Staff submits that MCPU should be directed to file rates in accordance with the adjustments recommended by Staff based on the proposed revenue requirement. The Commission finds Mt. Carmel's COSS to be a reasonable basis upon which to establish electric and gas rates in this proceeding.

#### 2. Rate Design

##### a. Electric

The Company proposed to eliminate the Electric Residential Controlled Water Heating Rate Class. The Company proposed the energy consumption billed under the controlled water heating tariff be transferred to the remaining two residential rate classes. Staff proposed the Company provide customer education materials to these

customers to better help them understand the change. Staff recommended approval of the elimination of the Controlled Electric Water heating tariff.

The Company also proposed that the loss of one customer in the Light and Power class required the income statement and rate base costs to be allocated to, and recovered from, the remaining electric service classes, however MCPUC requested the tariff remain in place for possible future use. Staff witness Harden agreed that the removal of the Light and Power class from the cost of service study is appropriate. Staff also agreed the Light and Power tariff should remain in place. Staff proposed an increase to the Light and Power class since all other classes will be increased and the rate should be based on this current rate case proceeding.

Staff recommends that its proposed electric rates on ICC Staff Exhibit 10.0; Schedule 10.01 E should be approved. If the Commission adopts a revenue requirement that differs from Staff's proposed revenue requirement, the rates in ICC Staff Exhibit 10.0, Schedule 10.01 E should be modified by the percent change of the revenue requirement approved by the Commission.

The Commission finds Staff's proposed electric rates are appropriate and should be approved, subject to changes in the revenue requirement deemed appropriate by the Commission elsewhere in this Order. The Commission finds that the rates shown in Staff Exhibit 10.0, Schedule 10.01 E are to be modified by the percent change of the revenue requirement approved by the Commission.

#### **b. Gas**

The Company did not propose any changes to the manner in which current gas rates are designed. The Company requested to maintain the current Industrial Gas tariff in order to preserve a service class for any future industrial gas load that may locate in the Company's service area. Staff agreed the Industrial Gas tariff should remain in place and proposed an increase to reflect the rising costs that resulted in the Company filing a rate case.

Staff recommends that its proposed gas rates on ICC Staff Exhibit 10.0, Schedule 10.02 G should be approved. If the Commission adopts a revenue requirement that differs from Staff's proposed revenue requirement, the rates in ICC Staff Exhibit 10.0, Schedule 10.02 G should be modified by the percent change of the revenue requirement approved by the Commission.

The Commission finds Staff's proposed gas rates are appropriate and should be approved, subject to changes in the revenue requirement deemed appropriate by the Commission elsewhere in this Order. The Commission finds that the rates shown in Staff Exhibit 10.0, Schedule 10.02 G are to be modified by the percent change of the revenue requirement approved by the Commission.



**c. Tariff Issues – Gas and Electric**

The Company proposed minor wording changes to the availability clause of the electric residential tariff. Staff recommended approval of the change to the electric residential tariff and also proposed the change be implemented in the gas residential tariff as well.

Staff proposed the Commission order the Company to file the approved rates and tariff sheets for both electric and gas within 10 days of the final Order, with an effective date of not less than 5 working days after the date of filing, for service rendered on and after their effective date, with individual tariff sheets to be corrected within that time period, if necessary.

The Commission finds both of these recommendations to be reasonable and they are adopted.

**B. Contested Issues**

**1. Commercial Space Heating Rate**

**a. MCPU Position**

Mt. Carmel notes that the City's witness, who by her own admission is not a utility expert, has recommended that the Commercial Space Heating rate class should receive no increase in revenue responsibility. MCPU submits that this is counter to the recommendations of expert testimony provided by Staff and MCPU. Mt. Carmel opines that the City ignores the fact that if that Commercial Space Heating were to receive no increase, it would simply serve to make the increases for other classes even higher. MCPU further notes that the City makes this recommendation without any option for what rate design changes their proposal requires. Mt. Carmel requests the Commission reject the suggestion of the City, and adopt the rate design suggested by Staff and agreed to by MCPU.

**b. Staff Position**

Staff maintains that the total class revenue increase for the commercial electric space heating service class should be 13.04%, while the City contends that the class should receive no rate increase. The City references the economic downturn in the community and states that the retention of business in Mt. Carmel is its overarching goal. The City argues that MCPU should structure its rates in favor of small business. The City also notes the Cost of Service Study showed that the commercial space heating class should receive a rate decrease.

In determining the rate of increase for the commercial electric space heating service class, Staff witness Harden testified that she considered the Cost of Service Study, but noted that it is not standard practice to use the exact results of the Cost of

Service Study to design rates. Ms. Harden testified that in addition to considering the study, she uses her professional judgment in making a determination of an appropriate rate design. She further notes that part of her decision making process is an attempt to prevent rate shock to other classes of customers.

Staff notes that the 13.04% increase recommended for the commercial electric space heating service class is the lowest increase recommended for any of MCPU's rate classes. Staff submits that of the other electric rate classes, there are only two that would receive less than a 20% total class revenue increase, the remaining classes would increase over 20%, and Staff therefore submits that the increase proposed for the commercial space heating service class is low in relation to the increase proposed for the other classes. Staff is of the opinion that a small rate increase for the commercial electric space heating service class is a better alternative than giving that class a decrease or no increase, which would result in rate shock to the other classes. Staff requests that the Commission accept Staff's recommendation of a 13.04% increase for the commercial electric space heating service class, subject to any changes ordered elsewhere in this Order.

**c. City of Mt. Carmel Position**

The City requests that the Staff's recommendation to give the commercial space heating class a rate increase be rejected, as the City submits that the cost of service study shows this class should receive a decrease. The City submits that it would instead be appropriate for this class to receive no rate increase.

The City opines that economic development and the retention of business in Mt. Carmel is an overarching goal of the City due to the economic downturn in the community, and the City believes that the Utility should structure its rates in favor of small business, and that the cost of service study provides the justification for doing so.

The City notes that Staff witness Harden initially testified that the Utility's cost of service study showed that the Commercial Electric Space Heating Service class should receive a decrease in revenue of 12% in order to produce the rate of return on rate base of 9.49%. The City submits that in her rebuttal testimony, Ms. Harden proposed increasing the class by 13.04%; however she agreed at hearing that it would not be incorrect for the increase to be lower than her recommendation.

The City submits that by allocating no increase to this class, the class still would recover more than is justified by the cost of service study, which would normally justify a rate decrease. The City further submits that allocating no rate increase to the commercial space hearing class would additionally benefit the City's attempt to bring economic development to the area.

**d. Commission Analysis and Conclusion**

The Commission is satisfied that the rate design proposed by Staff, and agreed to by Mt. Carmel, is appropriate for this proceeding, subject to any modifications adopted elsewhere in this Order. While the Commission recognizes the City's desire to keep a certain class of service low to possibly attract business, the City ignores the fact that this would cause an increase in the rates for every other class of customer. The City further failed to suggest or present any evidence on what in fact the new rates should be for the various classes. The Commission notes that rate design in a proceeding such as this involves competing objectives and might reasonably be considered part science and part art. As Staff noted, the decision on an appropriate rate for the commercial space heating class was in essence an attempt to spread the responsibility for a rate increase more evenly across all classes. The Commission approves of this treatment, and will adopt Staff's suggested rate design. The Commission believes that the rate design approved herein properly balances the competing objectives of establishing cost based rates, rate continuity, and the avoidance of rate shock.

**2. New Cost of Service Study**

**a. MCPU Position**

Mt. Carmel concurs with the position that the loss of its only customer taking service under its Electric Light and Power tariff has had a dramatic effect on the costs to be paid by other rate classes. Mt. Carmel suggests that should another customer take service under this tariff, MCPU would immediately establish communications with Staff to determine if the existence of a new customer should result in a reduction of rates and charges to other classes. Mt. Carmel notes a similar situation under its Industrial Gas Service Tariff, and suggests similar treatment for gas service.

**b. Staff Position**

Staff notes that the loss of one customer in the Light and Power class required the income statement and rate base costs be allocated to, and recovered from, the remaining electric service classes, however the Company requested the tariff remain in place for possible future use. Staff concurred with the removal of the Light and Power class from the cost of service study and that the Light and Power tariff should remain in place. Based on this information, Staff proposed that the final order in this proceeding should include a requirement that if a customer begins service under this tariff prior to the Company's next filed rate case; Mt. Carmel should file new electric rates for all customer classes, based on a cost of service study that reflects the inclusion of the new Light and Power customer. These new rates should be filed within 30 days of the date that service begins for the customer. Staff submits that this proposal is reasonable and will prevent MCPU from possibly being in an over-earning situation.

**c. City of Mt. Carmel Position**

The City generally agrees with the Staff that the Commission should order the Utility to prepare and file a new cost-of-service study and adjust its rates if a customer takes service under the Light and Power class. As Staff noted in its testimony, the loss of the only customer in this class changed what would have been a 12% to 18% rate increase request into a 28% to 38% rate increase.

The City agrees that if a new customer—such as a mine load—takes service under this rate in the future, it raises the possibility of “putting the Company into an over-earning situation.” It is for this reason that the Staff recommends in its brief that “new rates should be filed within 30 days of the date that the service begins for the customer.”

The City submits that MCPU’s suggestion of establishing communications with Staff should a new large customer be added is inadequate to protect existing customers, and requests that the Commission follow Staff’s suggestion of ordering a new cost of service study. The City further suggests that all parties to this docket should be notified when a new large customer is added to the MCPU’s system.

The City further submits that as MCPU has a Special Contracts Tariff in place, Mt. Carmel might use this tariff to avoid placing a customer under its Light and Power Class and thus avoid having to perform a new cost of service study, and possibly allow MCPU to be in an over-earning situation. The City suggests that Staff’s proposal be modified to cover any customer who is eligible under Mt. Carmel’s large customer tariffs.

**d. Commission Analysis and Conclusion**

The Commission notes that all parties agree that the loss of a large electric and/or gas customer for Mt. Carmel can have an adverse effect on the other rate classes. As the parties agree on the potential magnitude of gaining or losing a large customer, it appears appropriate to the Commission to order a new cost of service study to be performed by Mt. Carmel should a new customer begin taking service from Mt. Carmel who is eligible to take service under either the Light and Power Class or the Industrial Gas Service Class. The Commission does not deem it appropriate however to automatically require Mt. Carmel to file new tariff sheets and rates based on the results of the new cost of service study. The Commission finds that it is more appropriate to direct Mt. Carmel to provide a new cost of service study to the Manager of the Commission’s Rate Department within 60 days of a new large customer taking service from Mt. Carmel, and for Mt. Carmel and Staff to determine what appropriate further action is needed, if any. The Commission deems this a more appropriate response as no one of course knows when, or if, a new large customer may begin taking service, or what conditions may be for Mt. Carmel when this happens. In the Commission’s view, depending upon the circumstance, it is possible that rather than producing an over-earning situation, the addition of a large customer could instead allow

Mt. Carmel to defer an otherwise necessary increase in electric or gas rates. Thus, while the Commission believes the requirement to file a COSS is appropriate, the filing of new tariffs will not be mandatory. The Commission further does not find it necessary to direct Mt. Carmel to inform all parties to this docket when such a customer begins taking service, and finds that the actions ordered above are sufficient.

## **VI. FINDINGS AND ORDERING PARAGRAPHS**

The Commission, having given due consideration to the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Mt. Carmel Public Utility Company is an Illinois corporation engages in the distribution and sale of electricity and natural gas to the public in Illinois, and is a public utility as defined in Section 3-105 of the Act;
- (2) the Commission has jurisdiction over the parties hereto and the subject matter herein;
- (3) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record, and are hereby adopted as findings of fact and conclusions of law; Appendix A attached hereto provides supporting calculations for those portions of this Order concerning the electric delivery service operations of Mt. Carmel Public Utility; Appendix B attached hereto provides supporting calculations for those portions of this Order concerning the natural gas delivery service operations of Mt. Carmel Public Utility;
- (4) the test year for the determination of the rates herein found to be just and reasonable should be the 12 months ending December 31, 2006, as adjusted; such test year is appropriate for purposes of this proceeding;
- (5) for purposes of this proceeding, the net original cost rate base for Mt. Carmel's electric delivery service operations for the test year ending December 31, 2006, as adjusted, is \$12,273,453;
- (6) for purposes of this proceeding, the net original cost rate base for Mt. Carmel's gas delivery service operations for the test year ending December 31, 2006, as adjusted, is \$2,116,303;
- (7) a just and reasonable rate of return which Mt. Carmel should be allowed to earn on its net original cost electric and gas delivery service rate base is 9.35%; this rate of return incorporates a return on common equity of 12.10%;
- (8) the electric and gas delivery service rates of Mt. Carmel which are presently in effect are insufficient to generate the operating income to

permit Mt. Carmel the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently cancelled and annulled;

- (9) the specific rates proposed by Mt. Carmel in its initial filing do not reflect various determinations made in this Order regarding revenue requirement, cost of service allocations, and rate design; the proposed rates of Mt. Carmel should be permanently cancelled and annulled consistent with the findings herein;
- (10) Mt. Carmel should be authorized to place into effect tariff sheets designed to produce annual base rate electric revenues of \$11,174,961, which represent an increase of \$2,559,318, or 28.97%; such revenues will provide Mt. Carmel with an opportunity to earn the rate of return set forth in finding (7) above, based on the record in this proceeding, this return is fair and reasonable for Mt. Carmel's electric delivery service operations;
- (11) Mt. Carmel should be authorized to place into effect tariff sheets designed to produce annual base rate gas revenues of \$4,727,144, which represent an increase of \$599,518, or 14.47%; such revenues will provide Mt. Carmel with an opportunity to earn the rate of return set forth in finding (7) above, based on the record in this proceeding, this return is fair and reasonable for Mt. Carmel's gas delivery service operations;
- (12) determinations regarding cost of service, interclass revenue allocation, rate design, and tariff terms and conditions, as are contained in the prefatory portion of this Order, are reasonable for purposes of this proceeding; the tariffs filed by Mt. Carmel should incorporate the rates and rate design set forth and referred to herein;
- (13) new tariff sheets authorized to be filed by this Order should be filed with the Office of the Clerk for both electric and gas services within 10 business days from the date of this Order and reflect an effective date not less than 5 working days after the date of filing, with the tariff sheets to be corrected, if necessary, within that time period;
- (14) Mt. Carmel should additionally perform a study to determine the appropriate level of propane storage, and Mt. Carmel should provide this study to the Director of the Energy Division of the Illinois Commerce Commission within 150 days of the date of this Order;
- (15) Should Mt. Carmel begin providing electric or gas service to a new customer eligible to take service under either Mt. Carmel's Electric Light and Power Tariff or its Industrial Gas Service Tariff, Mt. Carmel is directed to perform a cost of service study that reflects the addition of a new large customer, and to provide the results of this new cost of service study to

the Manager of the Commission's Rate Department within 60 days of the date that service begins for the customer.

- (16) all motions, petitions, objections, and other matters in this proceeding which remain unresolved should be disposed of consistent with the conclusions herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets presently in effect for electric and gas delivery service rendered by Mt. Carmel Public Utility Company are hereby permanently cancelled and annulled effective at such time as the new electric delivery service tariff sheets and gas delivery service tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the proposed tariffs seeking a general increase in electric and gas delivery service rates, filed by Mt. Carmel Public Utility Company on May 4, 2007 are permanently cancelled and annulled.

IT IS FURTHER ORDERED that Mt. Carmel Public Utility Company is authorized to file new tariff sheets with supporting workpapers in accordance with Findings (10), (11), (12) and (13) of this Order, applicable to electric delivery services and gas delivery services furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that Mt. Carmel Public Utility Company is directed to perform a study to determine the appropriate level of propane storage, and Mt. Carmel Public Utility Company is further directed to provide this study to the Director of the Energy Division of the Illinois Commerce Commission within 150 days of the date of this Order.

IT IS FURTHER ORDERED that should Carmel Public Utility Company begin providing electric or gas service to a new customer eligible to take service under either Mt. Carmel's Electric Light and Power Tariff or its Industrial Gas Service Tariff, Mt. Carmel is directed to perform a cost of service study that reflects the addition of a new large customer, and to provide the results of this new cost of service study to the Manager of the Commission's Rate Department within 60 days of the date that service begins for the customer.

IT IS FURTHER ORDERED that all motions, petitions, objections, and other matters in this proceeding which remain unresolved are disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

Dated: February 1, 2008

Simultaneous Briefs on Exceptions due: February 15, 2008

Simultaneous Reply Briefs to Exceptions due: February 22, 2008

J. Stephen Yoder  
Administrative Law Judge